COMMONWEALTH OF MASSACHUSETTS
BEFORE THE
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

An Investigation By The Department Of	**)**	**D.T.E. 04-1**
Telecommunications And Energy Regarding The	**)**	
Assignment Of Interstate Pipeline Capacity Pursuant	**)**	
To <u>Natural Gas Unbundling</u>, D.T.E. 98-32-B (1999).	**)**	

REPLY COMMENTS OF ENERGY EAST SOLUTIONS, INC.

Pursuant to the schedule established in the Order Opening an Investigation Regarding the Assignment of Interstate Pipeline Capacity issued in the above captioned docket January 12, 2004 ("January 12 Order"), Energy East Solutions, Inc. (Energy East Solutions) respectfully submits these reply comments.

I. THE INITIAL COMMENTS IN A NUTSHELL AND A PRAGMATIC RECOMMENDATION

A bottom, the Initial Comments urge the Department to pursue one of three different approaches:

a. Option A: "***Do Nothing***". This approach, advocated by most of the regulated utilities, might be summarized as follows: "***since the promise of retail competition has not been fulfilled*** and since no workable competition has developed in the upstream capacity markets, the Department should continue to require mandatory "slice-of-the-system" capacity allocation."

b. Option B: "***Do Everything***". The opposite recommendation, from the Office of the Attorney General, counsels vigorous action to address several major issues and might be characterized like this: "***since the promise of retail competition has***

> ***not been fulfilled***, the Department should expand this proceeding to examine the broader issues of how LDCs plan and procure supplies and capacity; how to mitigate price volatility; the value of capacity auctions; whether mandatory capacity assignment should continue; and how to bring choice to customers who have none."
>
> c. Option C: "***Do the Essential Things to Remedy Operational and Administrative Burdens on Current Markets Before Deciding Whether or Not to Address Broader Policy Issues.***" In between these two views is the recommendation urged by EES, which might be summarized this way: "***since the promise of retail competition has not been fulfilled***, the Department should repeal its Capacity Fragmentation Policy and address the other unnecessary operational and administrative burdens on the market and give the market a chance to evolve naturally for a couple of years under a rational approach to capacity management before attempting to review the broader issues articulated by the Attorney General".

For the reasons detailed below, we submit that it is the third option -- the middle way -- that is the path of wisdom here and that we respectfully commend to the Department's consideration.

II. THE SEARCH FOR COMMON GROUND

In proceedings like the instant one where an agency is called upon to evaluate complex policy alternatives involving frequently competing interests, it is always helpful to look for the ***common core of fact*** upon which the various commenters agree. While an agreement on core facts does not always imply an agreement on the appropriate policies for dealing with those facts, it is at least a step in that direction. What, then, is the common core of fact upon which the Initial Comments agree?

1. ***The Department's policies have not resulted in an increasingly robust, competitive market for natural gas supply.***

Nearly all of the commenters agree that, contrary to the Department's expectations at the time it issued its 1999 order adopting the Capacity Fragmentation Policy,[1] the promise of retail competition has not been fulfilled. Simply put, the policies implemented in 1999 have not resulted in a robust competitive retail market for natural gas. This conclusion is amply documented in the initial comments:

Office of the Attorney General:

- The restructured Massachusetts gas industry "has not delivered what was promised", including broader consumer choice, increased efficiency and lower costs (Initial Comments, at 3).

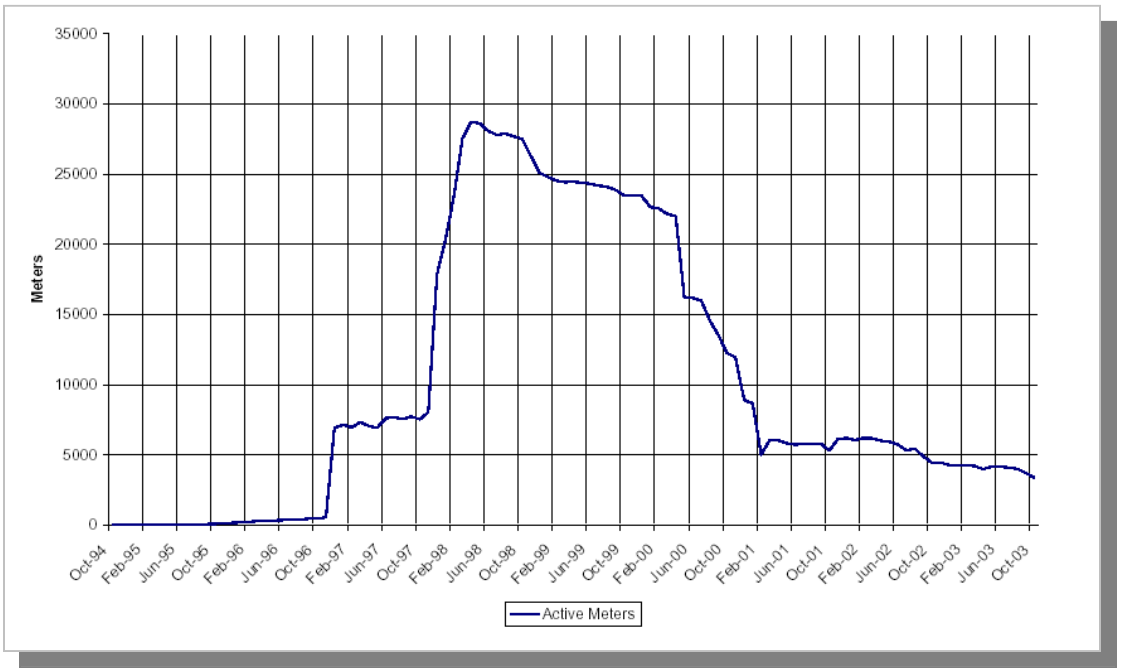
Fitchburg Gas & Electric Company d/b/a/ Unitil ("Unitil"):

- Number of competitive suppliers has diminished from 5 to 3 (and will shortly decline to just two). Initial comments at 2.
- Competitive suppliers currently serve less than two-tenths of one percent (0.155%) of all customers, down 50 percent from the peak market penetration of three-tenths of one percent (0.32%). *Id*., at 2. Competitive sales are currently less than 10 percent of total sales (January 2004), down from the peak market penetration of about 25 percent in august of 2001. *Id*.
- "Slice of system" approach can result in supplier being assigned as little as 1 Dth at a given meter supply point "***which essentially makes the assigned capacity of no use***" to the supplier. *Id.* at 4 (emphasis added).

[1] D.T.E. 98-32-B, issued February 1, 1999 (hereafter the "1999 Capacity Order"). The order is available on the Department's website at: http://www.state.ma.us/dpu/gas/98-32/98-32-b.htm.

Bay State Gas Company:

- The number of customers purchasing competitive supplies peaked in April of 1998 and plummeted following the Department's 1999 Capacity Order, falling over 80 percent from 1999 to 2001 before stabilizing. Initial comments, at 7, and Figure 1 (reproduced below).



- The number of competitive suppliers peaked in 1998 at 32 and has since fallen to just nine. (*Id*., at 8).
- About 1.1 percent of total customers purchase gas from competitive suppliers, accounting for some 25 percent of the total load. *Id.,* at 6.
- Company has experienced substantial "reverse migration" since Spring of 2000. *Id*., at 5.

NStar Gas:

- "[N]o circumstances" have occurred since the Department's 1999 ruling "that would support the conclusion that there is a workably competitive market for upstream capacity at this time." Initial Comments, at 2. *See also* at 5 ("competitive market structure for interstate pipeline and storage capacity does not yet exist" for Massachusetts customers);

- Transportation levels have remained "fairly constant" between 2001 and 2003. *Id.*, at 3, *citing* Appendix C.

Keyspan Energy Delivery New England

- Number of competitive suppliers has declined 50 percent, from 21 prior to the Department's 1999 Order to "just 11" today. Initial Comments, at 6. *See also* at 12 (Figure showing number of suppliers serving commercial/industrial customers 1997-2004).
- Percentage of commercial and industrial customers purchasing competitively-supplied gas diminished from 11.49 percent in January of 1999 to 7.63 percent in January of 2003 (although the percent of normalized C&I volume that was competitively supplied increased). *Id.*, at 13 (Table 3).
- The unbundling of residential customers is "virtually non-existent". *Id*, at 6.

Berkshire Gas Company

- While the number of competitively-supplied customers increased in November 2000 and peaked in November of 2002, the number of transportation customers declined thereafter, with an increase in customer inquiries regarding returning to utility service ("reverse migration"). Initial comments, at 5-6 (and Table 1).
- Number of competitive suppliers has "remained stagnant". *Id.*, at 6.

Blackstone Gas Company

- Number of transportation customers: none
- Number of marketers: none
- Percentage of market that has converted: zero[2]

Amerada Hess Corp.

- Massachusetts capacity assignment regime “such an overwhelming barrier” that “only a few marketers have been able to brave this market”. Initial Comments, at 15.

Select Energy

- “Slice-of-the-system” approach to capacity assignment is “fundamentally an unworkable methodology” that creates tiny and tinier capacity fragments that are “completely unmanageable”. Initial Comments, at 3.

---

[2] Initial Comments, at 1. Blackstone explains that due to restrictions on its pipeline tariff, the shipper is required to either a “pipeline, local distribution company or municipality”. *Id.*

New England Gas (Fall River & North Attleboro)

- Percentage of customers that have converted to transportation range from less than one-tenth of one percent (0.07 percent) on North Attleboro to a high of one-quarter of one percent (0.28 percent) on Fall River. Initial Comments (un-numbered attachment showing transportation customers as of February 12, 2004).
- Percentage of total volumes converted to transportation ranged from 10.72 percent on North Attleboro to 14.91 percent on Fall River. *Id*.
- Conditions in capacity market have "not yet matured". *Id*. at 3.

In sum, then the ***common core of fact*** in this proceeding is that the policies implemented pursuant to the 1999 Capacity Order have failed to achieve the Department's stated objective of creating a robust competitive retail market.

Indeed, the single most eloquent opinion expressed in the proceeding is not found in any of these comments, but rather in the silence of consumers, including the commercial and industrial consumers who were so vocal in advocating competitive access reform five to seven years ago. The Department should duly note that those who must allocate advocacy resources with an eye *towards bottom line value* apparently no longer see the same potential benefit from these proceedings than in the days preceding the Department's 1999 Capacity Order.

2. ***Are other areas of agreement among industry segments?***

While the commenters are nearly unanimous in the assessment that the policies have not achieved the stated objective of creating a robust competitive retail market in the Commonwealth, there is less agreement as to why that is the case. EES argued strongly in its Initial Comments that the Capacity Fragmentation Policy adopted in 1999 has been "one of the principal restraints" on the development of competitive retail access in the

Commonwealth over the last five years and has stunted the development of competitive retail markets in the Commonwealth. Initial Comments, at 6. While other factors may certainly enter into the equation, the difficulties created by the Capacity Fragmentation Policy are also identified as a key factor in a number of other comments. *See esp.* Initial Comments of Amerada Hess (Initial Comments at 4-7) (explaining how capacity fragmentation forces suppliers to "strand" capacity fragments, creating administrative and excess fuel costs; how administrative complexity of the dealing with fragmented capacity can "directly impact reliability" on peak days; and calling for the capacity fragmentation system to be streamlined "as expeditiously as possible"); and Select Energy (Initial Comments, at 3) ("slice of system" is "fundamentally an unworkable methodology" creating tiny fragments that are "completely unmanageable" when broken up into even tinier pieces and assigned to competitive suppliers.).

Indeed, seconding the comments in the 1997 Petition initially asking the Department to address the capacity fragmentation issue,[3] Unitil (Fitchburg Gas & Electric Light Company) expressly confirms the problems created by the capacity fragmentation policy, noting that fragmentation is so severe on its system that some capacity fragments are as small as a single dekatherm, which essentially makes the capacity "of no use" to the supplier. Initial Comments of Unitil, at 4. Unitil has suggested the adoption of an approach under which they would use a "proximate" slice of the system with some (not yet defined) mechanism to ensure cost equalization. Initial Comments, at 4.

[3] Petition of XENERGY, Inc. filed February 24, 1997 in D. P.U. 97-22.

3. *What the Department should do now: why a technical session to address capacity fragmentation is appropriate*

> *Pluralitas non est ponenda sine necessitas*
> -- William of Occam (1285- 1347)

Plainly, the results of the last five years have surprised many who thought that the Department's unbundling collaborative proceedings would lead to the development of a competitive Massachusetts gas market. While disappointment is understandable, surprise would appear misplaced in light of the various comments submitted to the Department in the late 1990s plainly and repeatedly identifying the fragmentation of upstream capacity under the "slice-of-the-system" methodology as a principal obstacle to the development of a competitive market.

With hindsight, it would appear that the error was in the Department's mistaken belief that any departure from the "slice-of-the-system" approach would *necessarily* produce unacceptable shifting of costs among suppliers and the consumers they serve. Having reached that (erroneous) conclusion, the rest of the conclusions of the 1999 Capacity Order followed logically: since cost-shifting was unacceptable and only the slice-of the system methodology could prevent such cost-shifting (so the Department believed), the Department concluded that it was bound to adopt the slice-of-the-system methodology even though that might slow the development of the competitive market.

As detailed by the Initial Comments, however, (EES, at 6-8, and Addendum; Unitil/Fitchburg at 4; Amerada Hess, at 5-6; Select Energy, at 3), path-based approaches can readily be married with a credit and surcharge mechanism that effectively eliminates the cost-shifting the Department seeks to avoid. Moreover, these approaches can be implemented in a manner that fully addresses the Department's concerns over ensuring that the capacity remains available at Massachusetts city gates -- and without prejudging subsequent action that the Department may choose to take to address the broader policy issues raised by other comments.

In seeking to solve complex problems, wisdom usually is found in solving the simple parts of the problem before tackling the more complicated aspects. It is a really a corollary of "Occam's Razor": the principle that the simplest solution that fits the facts of a problem is usually best.[4] In public policy analysis, the corollary is that when trying to solve a complex problem, one should usually try the simpler solution first.

Were he consulted today, William of Occam would certainly disapprove of capacity fragmentation under the "slice of the system" methodology in Massachusetts, with its unnecessary multiplication of capacity fragments, each one implying an entire tariff on file with the FERC with a multiplicity of nomination deadlines, balancing rules, etc. And William would surely throw up his hands when then informed that the cost-equalization objective that capacity fragmentation purports to serve could be achieved through a far, far simpler mechanism of crediting or debiting the shipper for the difference between cost of the average path and the actual path used. The key thing for

[4] While Occam's Latin phrase "pluralitas non est ponenda sine necessitas" is usually translated "plurality should not be posited without necessity", the wisdom behind it might almost be rendered as "keep thinking until you've found the simplest, most elegant, solution and don't make things any more complicated than you have to. " In the more pointed lingo of today, Occam gets reduced to the so-called "KISSS principle. *See, e.g.* http://wotug.ukc.ac.uk/parallel/www/occam/occam-bio.html.

the Department to remember here is this: the competitive suppliers that are still active in this market notwithstanding the trials and tribulations of the last five years -- Hess, Select, EES -- are unanimous in identifying capacity fragmentation under the slice-of-the-system approach as a key obstacle to competitive retail markets in Massachusetts. While each of these suppliers focuses also on other particular aspects of the operational rules (the algorithm problems identified by EES (at 12-13); the monthly limitations on releases and OFO problems identified by Hess (at 7-9); the SOLR issued mentioned by Select (at 3-4)), they are unanimous in identifying the Capacity Fragmentation Policy as ***the*** fundamental problem. And indeed, as noted above, Unitil (Fitchburg) has explicitly advocated the use of a "proximate" slice-of-the-system with a mechanism for ensuring cost equalization. Initial Comments, at 4.

Because the capacity fragmentation problem (together with the other operational issues) can be remedied easily and quickly -- ***and without compromising any of the other public policy objectives the Department seeks to accomplish*** -- we respectfully submit that the Department should promptly establish a technical session to try to develop a "path plus credit/surcharge" methodology that could be put in place as early as November of this year and develop solutions to the other important -- but limited -- operational issues identified in the initial comments.

If the Department determines that it wishes to examine the broader issues broached by the Office of Attorney General, that proceeding should be dealt with separately from the technical session to solve capacity fragmentation and the operational issues. Similarly, the technical session to end capacity fragmentation should be scheduled even if the Department determines that it does not wish at the present time to re-examine the question of the role of the LDCs in planning and procuring capacity.

We cannot stress strongly enough our understanding that a remedy to capacity fragmentation can be developed irrespective of whether the Department chooses to revisit the capacity planning and procurement role of the LDCs or not. It can be done; it *has* been done elsewhere; there is no reason why it cannot be done in Massachusetts.

III. CONCLUSION

Seven years ago, the Department received a complaint that the fragmentation of upstream capacity rights under the "slice of the system" approach was creating inhibiting the development of competitive markets in Massachusetts. That pleading did not seek to revolutionize retail markets nor did it promise magical reductions in energy prices. It called on the Department to remedy a serious practical problem that was obstructing the orderly evolution of competitive retail gas markets in the Commonwealth on a single LDC. Unfortunately, the 199 Capacity Order imposed that unworkable approach on the entire state, with the disastrous results for competition spelled out in the initial comments and summarized above.

Today, we respectfully reiterate the 1997 request.

Respectfully submitted,

ENERGY EAT SOLUTIONS, INC.

By: 

Philip M. Marston, Esq.
Its counsel

MARSTON LAW
218 N. Lee Street
Suite 300
Alexandria, VA 22314
Tel: 703-548-0154

March 29, 2004